



BOARD ADOPTED POLICIES

POLICY NUMBER: 2.10.100

EFFECTIVE DATE: 7/17/03

TITLE: Public Markets Equity – Retirement Funds

SUPERSEDES: 7/1/02

BOARD ADOPTION: 7/17/03

APPROVED: *Joseph A. Dear*

PURPOSE:

This document outlines the investment policy and objectives for the Public Markets equity segment of the Washington State Investment Board (WSIB) Commingled Trust Fund (CTF) and supersede any prior Board-adopted policies. This policy and objectives allow for sufficient flexibility in the management process to capture investment opportunities, yet provide parameters that will ensure prudence and care in the execution of the equity investment program.

POLICY:

Strategic Objectives

Within the context of available investment opportunities, the Board's assessment of risk, and the principle of diversification, the WSIB's asset allocation is to be managed over time to maximize return at a prudent level of risk (RCW 43.33A.110 and 43.33A.140).

To achieve this objective, the Public Markets equity program seeks to:

1. Achieve the highest return possible consistent with the desire to control asset volatility.
2. Ensure protection for long-term liabilities since shorter-term liabilities are more suitably protected by lower volatility instruments such as fixed income securities.
3. Provide diversification to the WSIB's overall investment program.

General Strategies

1. The Public Markets equity portion of the CTF includes strategies in the U.S., international developed markets, and international emerging markets.
2. A mix of external managers approved by the Board will be used to implement the equity program.

3. Passive index funds will be used in markets that are generally efficient to promote a diversified structure, while controlling risk and minimizing costs.
4. Active, structured, or specialty managers may be used to invest in markets that are less efficient and should actively seek to enhance returns while managing risk.

Investment Approach and Objectives

The Public Markets equity investments will be managed to the asset allocation targets and ranges adopted by the Board. The targets are long-term and may deviate in the short-term as a result of interim market movement and market impact/costs to implement the reallocation.

A. U.S. Equity

Since the U.S. equity markets are generally efficient, the domestic equity portfolio is entirely (100 percent) passively managed. Over time the domestic equity portfolio should closely track the return of a specified broad U.S. market benchmark, currently the Wilshire 5000 Index.

B. International Equity

International markets are generally less efficient than the U.S. market; therefore, more active management will be included in the approach taken with international markets. The Morgan Stanley Capital International (MSCI) All Country World Free ex. U.S. Index (ACWI Free ex. U.S.) will serve as the benchmark for the WSIB's entire international program.

1. The *international developed markets* portfolio will be invested 60 percent in active strategies and 40 percent in indexed and enhanced index strategies. The portion that is indexed will represent a diversified core portfolio that closely tracks a broad developed markets benchmark, such as the MSCI Europe, Australia, and Far East (EAFE) + Canada Index.

The portion that is invested in an enhanced index strategy, if any, will also be part of a diversified core portfolio but will seek to marginally outperform (.50 percent/50 basis points) a broad developed markets benchmark, such as the MSCI EAFE + Canada Index.

The actively managed portion of the international developed markets program seeks to hire managers that are willing to deviate from the benchmark and, thus, strive to markedly exceed the returns of the passive benchmark. These active developed managers will be benchmarked against the MSCI EAFE + Canada Index.

The WSIB will seek to invest 30 percent of the actively managed international developed markets equity assets with growth oriented managers, 30 percent with value oriented managers, and 40 percent with core managers.

2. Since *international emerging markets* are even less efficient than the international developed markets, the WSIB will actively manage 100 percent of its emerging markets exposure. The benchmark for the active managers is the MSCI Emerging Markets Free index (MSCI EMF).

Equity Manager Guidelines

1. Each equity manager will have guidelines that describe the specific investment approach and general strategies to be used in the management of the assigned assets. Equities will be invested based on general allocation targets and market conditions.
2. Permissible public market equity investments include the common and preferred stock of publicly-traded companies in the U.S. and international markets. Managers may use derivative instruments only in accordance with the WSIB policies and manager guidelines. Specialized use of derivatives by managers must have prior approval by WSIB staff on a case-by-case basis. Managers' use of derivatives for speculation is specifically prohibited.
3. The following transactions are prohibited: uncovered short sales, portfolio leveraging or trading on margin (not applicable to initial margin on futures transactions), straddles, naked options, and any other transactions prohibited by statute or the WSIB.
4. The international developed markets managers may invest up to 15 percent of the portfolio (at market) in international emerging markets securities.
5. The international developed markets managers may invest in small-cap securities; the WSIB reserves the option to limit small-cap exposure at some future date.
6. The Board's long-term view of international equity investing and currencies eliminates the need for a currency overlay program; however, the Board will allow individual international managers to manage the currency exposures related to their portfolio.

Reporting

1. WSIB staff will report equity investments and allocations to the Board monthly.
2. Appropriate consultants and/or staff will report investment structure and performance to the Board quarterly.
3. As warranted staff will report changes related to the investment managers and significant deviations in performance.

RESPONSIBILITIES:

Washington State Investment Board - Responsible for approving the strategic policy.

Public Markets Committee - Responsible for reviewing and recommending strategic policy to the Board. The Public Markets Committee is responsible for monitoring the equity allocation relative to this policy and the allocation and rebalancing of the managers' portfolios

WSIB Staff - Responsible for implementing policy, monitoring the investment managers' asset class structure, managing the overall Public Markets equity program, and reporting to the Public Markets Committee and the Board.

Original Policy Adopted 6/29/81

Revised 8/9/82

Revised 11/14/83

Revised 9/15/92

Revised 11/18/93

Revised 7/21/94

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